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No. 06-937

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IN THE

Supreme Court of the United States

QUANTA COMPUTER, INC., *et al.*,
Petitioners,

v.

LG ELECTRONICS, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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SUPPLEMENTAL BRIEF FOR RESPONDENT

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ARGUMENT

The Government's uncharacteristically limited basis for recommending review is that the Federal Circuit's rule since 1992, *i.e.*, that an otherwise-lawful condition on a sale can preserve patent rights, "appears" to conflict with certain older decisions of this Court. Even if that claim were correct, it would not justify certiorari. There is simply no problem in the patent world that warrants review of the basis on which licenses have been written for the past 15 years—either to reaffirm it (the Government stops short of urging otherwise) or to redefine it (unsettling existing contracts).

The Government's brief offers literally no support for the assertion that the issue here has produced practical problems. It does not allege any inter- or intra-circuit conflict or confusion. And it does not cite *any* source documenting a real-world problem or uncertainty regarding exhaustion generally, let alone narrower issues concerning sales under contract limitations. Those omissions positively confirm the absence of any difficulty in the patent world, because the Federal Circuit approach has been in place for 15 years. Moreover, even under the Government's unduly narrow view of the key precedent, *Mitchell v. Hawley*, 83 U.S. 544 (1873), the difference between losing and preserving patent rights against downstream assemblers remains merely one of parties' drafting. Certiorari is not warranted to address a non-existent problem or to review the form in which market-place transactions should take place.

In any event, the Government's reading of this Court's decisions is unsound. No decision of this Court holds that patentees lose their patent rights based on sales made only under restrictions that themselves are lawful (violating no antitrust, patent misuse, or other bar). *Mitchell* positively establishes that a patentee-imposed restriction on the use rights a licensee may convey when selling an article preserves the patentee's rights against the purchasers for use contrary to

the restriction. And the Government can cite no contrary decision, including *United States v. Univis Lens Co.*, 316 U.S. 241 (1942), which involved an *otherwise-illegal* sale restriction, not an otherwise-legal one, and thus is fully consistent with the Federal Circuit's rule.

In the end, exhaustion is part and parcel of, not different in kind from, implied license, as *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 484 (1964), recognizes, setting only a *default* consequence that parties may avoid by lawful redefinition of the rights conveyed. Neither the statute nor policy nor precedent supports a doctrine that curtails the freedom of patentees and users of their technology to define in otherwise-lawful ways the rights transferred and how compensation shall be spread out. Such definition is what took place here (in contracts that Intel still keeps partly secret)—the Government accepts that the circumstances negated any implied license—and what occurs successfully throughout the technology world.

For at least those reasons and other previously stated—for example, the case is interlocutory in posture, and set for trial in January, including on *method* claims, which the Government recognizes this Court has never held subject to exhaustion, *see* USBr. 17—the petition should be denied.

A. The Government's View of This Court's Precedents, Even If Correct, Does Not Justify Review

Even if the Government's view of this Court's precedents were correct, certiorari should be denied. The Government recognizes that the approach to exhaustion at issue is hardly novel, but has prevailed in the Federal Circuit for the past 15 years. *See Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992). The Government never declares that approach to be wrong or argues for its rejection if reviewed. It says only that the *Mallinckrodt* rule, that an otherwise-valid condition on a sale can preserve patent rights, "appears to

conflict" with certain opinions from this Court. USBr. 6; *id.* at 6-17. But even if that premise is accepted, the Government has not justified certiorari. The Government is urging the Court to address a problem that does not exist, to undertake a debate about the mere form in which market transactions could occur even under the Government's view of cases, and possibly to unsettle existing contracts.

The Government offers no evidence whatever that the *Mallinckrodt* rule, or any uncertainty about its consistency with this Court's decisions, has caused any difficulty, jurisprudential or practical. The Government's brief discussion of importance (USBr. 17-19) alleges no intercircuit or intracircuit conflicts or confusion on the matter. It cannot say that *Mallinckrodt* either has produced or could validate contract restrictions violating antitrust or other proscriptions, because *Mallinckrodt* expressly says the opposite. 976 F.2d at 708 ("Unless the condition violates some other law or policy (in the patent field, notably the misuse or antitrust law, *e.g.*, [*Univis*]), private parties retain the freedom to contract concerning conditions of sale."). *Mallinckrodt* fully preserves all policies that make *particular* conditions improper and hence precludes worries about anticompetitive arrangements. The Government is thus left only to make the naked, unsupported assertion that the issue is "of substantial ongoing practical importance," with guidance (content unspecified) "much needed." USBr. 17, 19.

The Government cites literally no support for that claim. If the issue were causing significant problems in practice, there would by now be a record of cases, or a literature (legal, economic, professional), documenting such problems—whether caused by the 15-year-old *Mallinckrodt* approach itself or caused by "dissonance" (USBr. 18) with this Court's decisions. In fact, exhaustion issues arise only occasionally, and there is no basis for finding a marketplace difficulty. The Government's inability to cite any contrary proof whatever

confirms that there is *no* problem needing attention here. That fact makes this case sharply different from other patent cases recently reviewed by this Court, which involved issues (obviousness, injunction, doctrine-of-equivalents standards) that arise daily and had produced lower court confusion and indications of real-world problems. *See* Opp. 12-14.

Other facts confirm that the issue here has generated no real-world problem. *First*, unlike in other recent patent cases, the business community here is all but silent. The only amici urging review (an inherently one-side presentation) are (a) three customers of petitioners (Dell, HP, Gateway) with a direct interest in this particular case and (b) a business (Minebea) that had an exhaustion case that has since settled. *Second*, the Justice Department and FTC have comprehensively studied patent issues in recent years. Tellingly, exhaustion has not been identified as even warranting discussion as a serious problem.[1]

Finally, the Government's own view of this Court's precedents confirms that the ruling lacks practical importance. Even under that (unduly narrow) view, the preservation of patent rights is just a matter of contract drafting. The Government recognizes that, ever since *Mitchell* (1873), patentees have been fully able to preserve their rights by avoiding the language of sale subject to restriction and instead drafting their licenses to manufacturers in use-license language. USBr. 12-14. Although that language should not be necessary, the Government recognizes that it is effective if adopted. The precise location of the line for preserving patent rights is not certworthy when it remains a matter for private drafting to accomplish the result of preservation. *See*

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[1] *See* U.S. Dep't of Justice and FTC, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (Apr. 2007); FTC, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (Oct. 2003); U.S. Dep't of Justice and FTC, *Antitrust Guidelines for the Licensing of Intellectual Property* (1995).

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Opp. 2, 15-16. The form of transactions, when the market effects could be unchanged, is not a matter needing attention. And a sudden change in the basis on which contracts have been written for 15 years could be harmfully unsettling.

In short, the Government's sole basis for recommending review is a claim that stops short of saying that *Mallinckrodt*'s clear 15-year-old rule is wrong or harmful, but asserts only that the rule "appears" inconsistent with some older decisions of this Court. In the utter absence of a problem caused by *Mallinckrodt*, that is insufficient to support certiorari.

B. The Government's View of This Court's Precedents Is Incorrect

In any event, the Government is wrong in its view of what this Court's precedents might require. The Government's view of the cases rests on two principal errors. It does not give *Mitchell* its proper significance as supporting *Mallinckrodt*. And it misreads *Univis* as contradicting *Mallinckrodt*.

The Government says that the Court's decisions treat exhaustion as an "implied-in-law license under the patent laws to practice the patent." USBr. 8. But that characterization (like the formulation, "delimiting the exclusive rights," USBr. 7) just leads to rather than answers the question at issue: whether the "implied in law" license based on first sales, unlike licenses implied in law based on other circumstances, is immune from alteration by parties' otherwise-valid sale conditions. *Mallinckrodt* ruled that parties *can* alter the default implication of patent-practicing authority by adopting restrictions, but only if the restrictions are themselves lawful—a distinction that reflects the sensible notion that an *unlawful* act may not be invoked to override an implication of authority that a sale otherwise conveys. Although the Government suggests that this Court's precedents "appear[]" to conflict with *Mallinckrodt*, there is no

such conflict: no case finds exhaustion or establishes an exhaustion doctrine that overrides an otherwise-valid restriction attached to a sale.

In fact, the most pertinent precedent of this Court, *Mitchell*, long ago established the *contrary* view. The Government itself recognizes that *Mitchell* permits patentees to preserve patent rights by limiting the rights transferred. USBr. 12-14.[2] Although the Government would limit *Mitchell* to mere licenses to use, distinguishing "sales" under restrictions, USBr. 13, that reading is inconsistent with the Court's own characterization in *Mitchell*. Not only, as the Government recognizes (USBr. 16), does *Mitchell* state the exhaustion principle for patentees who have "*sold*" a patented machine "without any conditions." 83 U.S. at 547 (emphasis added). But *Mitchell* repeatedly describes what occurred as *sales* of the hat-felting machines, under use restrictions.[3] Not sur-

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[2] Although the Petitioners' Reply Brief (at 3) suggested that *Mitchell* was overruled in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917)–itself superseded in part by statute, *see Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281, 1290-91 (2006)–that is not so. The Court relied on *Mitchell* expressly in *General Talking Pictures Corp. v. Western Elec. Co.*, 305 U.S. 124, 127 (1938), and *United States v. General Elec. Co.*, 272 U.S. 476, 489 (1926), and implicitly in *Univis*, 316 U.S. at 251 (invoking the "cases collected in *General Talking Pictures* . . . , 305 U.S. 124, 128, note 1," including *Mitchell*'s "without any conditions" statement of exhaustion from sales).

[3] 83 U.S. at 549 (Bayley "sold the machines" to Mitchell et al. in 1864); *id.* ("purchasers"; "the four machines which [Mitchell et al.] purchased"; "the purchase"); *id.* at 550 ("the purchasers"); *id.* at 551 ("the purchasers"); *id.* (terms of sale to "the purchasers were sufficient to put them upon inquiry" about the limited use rights).

The sales were condition*ed*, not "conditional" (USBr. 16); the latter concept does not appear in *Mitchell*. The Government's highlighting of parts of quotes (USBr. 13) mistakenly suggests that the Court said that Bayley neither did nor could sell the machines. None of the quotes say that, and the Court repeatedly described the machines as having been sold.

prisingly, the important 1890 Robinson treatise expressly recognizes that, under *Mitchell* and other authorities, a condition can indeed prevent loss of patent rights in a "sale." 2 W. Robinson, *The Law of Patents* § 824 at 617-24 (1890). As the Government notes (USBr. 10 n.4), this Court likewise so recognized in *Henry v. A.B. Dick Co.*, 224 U.S. 1, 19-25 (1912).[4]

A view of exhaustion as an unalterable loss of patent rights is also strongly undermined by this Court's express treatment of both the 1942 *Univis* decision and the prominent exhaustion case of *Adams v. Burke*, 84 U.S. 453 (1873), as involving an "implied license to use." *Aro*, 377 U.S. at 484. That treatment properly views exhaustion as a species of "implied license," subject to lawful action that cancels the implication. Further, a rigid distinction between use licenses and conditioned "sales" is out of step with the law's broader recognition that property is a "bundle" of different rights a person may have, and may separately decide to sell, in a particular article. *See United States v. Craft*, 535 U.S. 274, 278 (2002); *Andrus v. Allard*, 444 U.S. 51, 66 (1979).

Against all the foregoing, the Government cannot point to any precedent of this Court that conflicts with the *Mallinckrodt* rule that otherwise-valid conditions can avoid exhaustion. Most of the Government's quotations merely state the general

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What Bayley could (and did) not sell was the machines *with* the post-May 1867 use rights at issue.

[4] Although the Government suggests otherwise (USBr. 10 n.4), neither the elaboration of general principles in *A.B. Dick* nor the decision in toto was overruled in *Motion Picture Patents*, which repudiated only *A.B. Dick*'s holding that patent law protected even a particular kind of restriction, namely, a tying arrangement involving nonpatented articles. *Motion Picture Patents*, 243 U.S. at 518. Any claim of general overruling is flatly inconsistent with this Court's repeated reliance on *A.B. Dick*'s legal analysis since *Motion Picture Patents*. *E.g.*, *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, 545 U.S. 913, 932-33, 935, 943 (2005); *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808 (1988).

exhaustion principle *where no restriction attached to the sale was even at issue*, and thus could not and do not determine the effect of such a restriction. USBr. 6-10, 16.[5] Ultimately, therefore, the Government must rely on the 1942 *Univis* decision to seek support for exhaustion as limiting "the patent right in a manner that cannot be extended or altered by the parties" through otherwise-valid restrictions. USBr. 11. But *Univis* does not establish or even state such a doctrine.

All that *Univis* held was that patent rights were not preserved by sale restrictions that *were otherwise illegal* (under the Sherman Act). *Mallinckrodt* does not conflict with that holding but expressly incorporates it. 976 F.2d at 708. That is enough to defeat reliance on *Univis* as conflicting with *Mallinckrodt* and thus justifying review.

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[5] The Government (USBr. 7, 17) misreads dicta in *Keeler v. Standard Folding-Bed Co.*, 157 U.S. 659, 741 (1895), as stating that sale restrictions are enforceable only as contracts, and not preserving patent rights. *Keeler* noted that "[w]hether a patentee may protect himself and his assignees by special contracts brought home to the purchasers *is not a question before us*" but that "such a question would arise as a question of contract, and not as one under *the inherent meaning and effect* of the patent laws." (emphasis added). That statement does not limit enforceability of sale restrictions to contract law: it says only that curtailing the use rights of a purchaser requires a licensing restriction, as such curtailment is not "inherent" in patent law itself, *i.e.*, the default of exhaustion must be overcome. Indeed, *Hobbie v. Jennison*, 149 U.S. 355, 363-64 (1893), said in dicta that "[i]t is easy for a patentee to protect himself . . . . He can take care to bind every licensee or assignee, if he gives him the right to sell articles made under the patent, by imposing conditions . . . ."

In *Bloomer v. McQuewan*, 55 U.S. 539 (1853), also cited at USBr. 7, 17, there was no question of use in violation of a restriction imposed on a sale: the question was use after a certain time, but "[t]he right to construct and use these planing machines, had been purchased and paid for without any limitation as to the time for which they were to be used." 55 U.S. at 553. And *Motion Picture Patents*, cited at USBr. 7, which involved tying, made a statement limited in terms to nonpatented articles ("supplies") to be used with the patented machine. 243 U.S. at 509.

In addition, even the Court's reasoning in *Univis* is narrower than the Government suggests. *First*, in reasoning that the sale of lens blanks conferred a "license" to practice the patents on finished lenses, the Court did not assert a legal consequence of any first sale regardless of patentees' terms of sale; rather, it expressly relied on the *particular* terms of sale, immediately tying its "license" conclusion to the patentee's choice to seek no further payment for the lens blanks. 316 U.S. at 249-50; *see id.* at 245. *Second*, the Court's reasoning treated the sales at issue as without legally cognizable conditions. Seemingly reflecting the idea that sale restrictions that are independently illegal may not be invoked to negate a patent-practicing authority otherwise implied from the sale, the Court evidently put aside the challenged price-fixing restrictions for its patent discussion and treated the patentee's sale of blanks to finishers as if it "had sold the blanks to a wholesaler or finishing retailer, *without more*." 316 U.S. at 251 (emphasis added). Nowhere does *Univis* say that patent rights cannot be preserved by any otherwise-valid restriction. Accordingly, the Government's view of precedent as possibly conflicting with the Federal Circuit view of conditioned sales is incorrect.[6]

Significantly, the Government's *sole* concern is one of precedent. The Government cites no statutory or policy basis for barring a patentee from preserving its rights by imposing on sales a restriction that itself violates no antitrust or other proscription. And there is no such basis.

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[6] After *Univis*, Congress in 1952 enacted 35 U.S.C. § 271(d)(2) to state that a patentee "otherwise entitled to relief" for direct infringement shall not "be denied relief" ("or" be found guilty of "misuse") on the very basis asserted here to trigger exhaustion—licensing sale of nonpatented components with no substantial noninfringing use. *See* USBr. 20 n.7. The Federal Circuit, not presented with Section 271(d)(2), has not yet addressed the provision's meaning in the present situation.

The statute grants relevantly unqualified exclusivity rights to patentees, 35 U.S.C. §§ 154, 271, and the Government cites nothing in the Patent Act that restricts the patentee's *general* control over how it will parcel out those rights and collect compensation—subject to condemnation for violation of any legal constraint on *particular* conditions. Nor is there any policy justification for the version of exhaustion that petitioners promote. Such a doctrine would judicially displace the marketplace freedom of patentees and technology users to negotiate separate payments at separate market levels to meet differing economic circumstances (rather than forcing a component maker to pay the full value and build that cost into *its* prices), or would treat use licenses as sharply different from restricted "sales" (which could increase uncertainty by producing litigation over formalities despite, as here, the clarity of the restrictions as a substantive matter). No justification has been established for such judicial restrictions on the workings of the market for exercising patent rights—which, of course, are presumed valid for present purposes. Thus, the *Mallinckrodt* rule is sound and—in the absence of any demonstrated problem or a true conflict with this Court's precedents—should not be reviewed or disturbed.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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